IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

NO. 77-648

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

PENNZOIL PRODUCING COMPANY, ET AL.,
Respondents.

BRIEF OF SHELL OIL COMPANY IN OPPOSITION TO THE PETITION OF THE SOLICITOR GENERAL FOR WRIT OF CERTIORARI

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STATEMENT OF POSITION AND SUMMARY OF ARGUMENT

Shell Oil Company ("Shell"), Respondent herein and Petitioner in the Court of Appeals below,[1] respectfully submits that the Petition in the captioned case should be

1. Separate Petitions for Review from the same Commission Orders were filed by Pennzoil Producing Company (Case No. 76-1626), Shell Oil Company (Case No. 76-1831) and United Gas Pipe Line Company (Case No. 76-2128), in the U.S. Court of Appeals for the Fifth Circuit. These cases were consolidated by that Court for purposes of briefing, argument, and decision.

denied and the Opinion of the Court of Appeals for the Fifth Circuit be permitted to stand. The Questions Presented by Petitioner do not involve any discretionary action by the Federal Power Commission (now succeeded by the Federal Energy Regulatory Commission, and herein called "Commission"). They involve findings by the Commission that *it had no power or authority* under the Natural Gas Act and the decisions of this Court to grant the relief requested by Shell. The Court of Appeals properly found that the Commission *did* have authority to grant either of the two alternative forms of relief requested, and remanded the case to the Commission for consideration of the case on the merits. Should the Court of Appeals' decision be reversed and the Commission upheld, this action, when considered with other decisions of the Commission, will result in denying Shell the opportunity to recover its reasonable and legitimate costs on the leases here in question in *any* proceeding before the Commission.

ARGUMENT

I. The Commission Has Misconstrued This Court's Decision in *F.P.C. v. Texaco Inc.*[2] Both in Its Decision Below And Its Petition Here.

The basic fallacy in the Commission's Opinion below, and its Petition here, is a mistaken reading of the Court's Opinion in *Texaco, supra.* In *Texaco,* this Court reversed an attempt by the Commission to regulate prices for sales in interstate commerce by small producers *solely* on the basis of unregulated intrastate market prices. This Court went ahead to point out that had the Com-

2. 417 U.S. 380 (1974).

mission considered "other factors" as well as the market price, the decision would have been different,[3] citing *Austral Oil Co. v. F.P.C.,* 428 F.2d 407, 441 (C.A. 5), certiorari denied, 400 U.S. 950.[4] To read *Texaco* as precluding *any* consideration of market values or non-cost economic factors would place it in conflict with this Court's decision in *Mobil Oil Corp. v. F.P.C.,* 417 U.S. 283, 317-320, decided in the same term, as well as this Court's earlier decisions in *Permian Basin Area Rate Cases,* 390 U.S. 747, 796-798 (1968) and *F.P.C. v. Sunray DX Oil Co.,* 391 U.S. 9, 32 (1968). *Permian* specifically authorized the Commission to consider factors other than costs in determining producer rates under Sections 4 and 5, and *Sunray* authorized the Commission to consider contract prices which had not received Commission approval in fixing ceiling prices permitted under Section 7 of the Natural Gas Act.

In fact, in *Mobil, supra,* this Court suggested the very relief that the producers sought here, and which the Commission now asks this Court to find it has no power to grant. In that case Mobil Oil Corporation, Petitioner, attacked the Commission's *Southern Louisiana Area Rate Decision,* 46 F.P.C. 86, affirmed *Placid Oil Co. v. F.P.C.,* 483 F.2d 880 (5th Cir. 1973), on the grounds that the Commission had failed to consider an adjustment to the area ceiling rate for higher royalty costs based on market

3. The record clearly reflects that the settlement price agreed to by Shell and the Williams reflected "other factors" besides the intrastate price for gas in the area, including th FPC ceiling prices, the termination of the litigation to cancel the lease, and the need to drill additional wells free of the cloud on the title created by the lawsuit.

4. 417 U.S. at 397-99.

value royalty provisions of the type involved here. This Court said:

> "We agree with the Court of Appeals that Mobil's argument is hypothetical at this stage and that in any event an affected producer is entitled to seek individualized relief."
>
> * * *
>
> "'If, as subsequent events develop, the producers are put in a bind by their royalty obligations, they may certainly petition FPC for individualized relief. Permian contemplated it.' 483 F.2d at 911" (417 U.S. at 328)

As the Court of Appeals found, "Shell and Pennzoil have been put in such a bind" (553 F.2d at 488). The record reflects that if the lessor prevails in the State Court action,[5] and all special relief is denied, Shell will suffer a net *loss* of 3.5 cents for each Mcf of gas it sells from one of the two leases here in question.

However the royalty due to the lessor is determined, it remains a *cost* to the lessee-producer. The possibility that the lessor's percentage royalty may be based on some price higher than the lessee is entitled to receive for the gas under Commission regulation, is a cost which the Commission has *not* taken into account in establishing the area and national ceiling rates for producers, see *Mobil, supra; National Rate Proceeding for New Gas,* 51 F.P.C. 1446, 52 F.P.C. 1604,[6] affirmed, *Shell Oil Co. v. F.P.C.,* 520 F.2d 1061 (5th Cir. 1975), certiorari denied, *sub nom. California Co. v. F.P.C.,* 426 U.S. 921 (1976); *National Rate Proceeding for Sales of Natural Gas Produced From Wells Commenced Prior to January 1, 1973,* Opinion Nos. 749 and 749-C, ___ F.P.C.___ and ___ F.P.C. ___, respectively, appeal pending, *Tenneco Oil v. F.E.R.C.,* Case Nos. 76-2960, *et al.,* (5th Cir.). It is particularly ironic that in Opinion No. 749-C (at page 27 of the mimeo opinion), *supra,* issued July 19, 1976, the Commission again rejected any adjustment to the national ceiling rate for royalty calculated at a rate above the Commission's ceiling price on the grounds that "a producer affected by higher royalty obligations is entitled to seek individualized relief", citing *Mobil* and *Placid, supra.* The Commission's position appears to be that the producer is always in the wrong case to obtain relief from the additional costs created by the market value royalty provision.

5. The result which cannot be ignored, in the light of *J.M. Huber Corporation v. Denman,* 367 F.2d 104 (5th Cir. 1966) and *Texas Oil and Gas Corp. v. Vela,* 429 S.W.2d 866 (Tex. 1966).

6. The cost study utilized by the Commission to establish the national ceiling rate in this case assumed a national average royalty of 16 percent, 52 F.P.C. at 1690.

II. Under Section 7(b) Of The Natural Gas Act, The Commission Has Authority To Grant Partial Or Total Abandonment Upon A Finding That "The Present Or Future Public Convenience And Necessity Permit Such Abandonment".[7]

Petitioner seeks to deny the Commission a power clearly granted it under Section 7(b) of the Natural Gas Act, which authorizes the Commission to grant abandonment upon a finding that such abandonment is in the present or future public convenience and necessity. The record contains ample evidence upon which such a finding

7. 15 U.S.C. § 717f(b).

could be made. But the Commission never considered this evidence, concluding on the basis of its decision in *El Paso Natural Gas Co.*, 54 F.P.C. 145, reversed *sub nom. Southland Royaly Co. v. F.P.C.*, 543 F.2d 1134 (C.A. 5), certiorari granted June 27, 1977, *California, et al. v. Southland Royalty Co., et al.*, Case Nos. 76-1114, *et al.* October Term, 1977, that even if Shell's leases were cancelled, or made uneconomic by refusal by the Commission to allow recovery of royalty costs, the gas would nevertheless remain committed to interstate commerce. The Court of Appeals found that the grounds relied upon by the Commission swept away by its reversal of *Southland*,[8] and therefore the Commission must consider the issue on the merits. Obviously, if this Court sustains the decision of the Court below in *Southland*, it must sustain the Court below here. But even if the *Southland* decision is reversed, the Commission's decision on the abandonment question here, still cannot stand. The Commission is stating that *as* a *matter of law* it has *no authority* to grant abandonment under the circumstances of this case.

In taking this position, the Commission completely ignored the undisputed evidence that its actions will result in the confiscation of Shell's leases if the royalty owner prevails in his litigation. The fact that the record shows that two additional wells planned on these leases have been indefinitely deferred because of the litigation and the Commission's position, is not considered, even though the pipeline purchaser, United Gas Pipe Line Company curtailed the supply of gas to over 50 percent of its contract obligations last winter. The ability, or the inclination, of the royalty owner to additionally develop the leases if he obtains the title thereto, is not considered. The only question considered by the Commission is whether the loss of Shell's lease could result in loss of the seven-eights (7/8th) of the gas stream to the interstate market. Having concluded (we believe erroneously, for all of the reasons given by the Court of Appeals in *Southland, supra*) that it could not, the Commission takes the position that it *has no authority* to consider the record, or any other factors which may bear on its responsibility to determine whether abandonment of the one-eighth (1/8th) interest *would* be in the "present or future public convenience and necessity". The Court of Appeals properly found that is not the law.

8. See the Court of Appeals' language at page 9a of Appendix A to the Petition for Writ. The first three sentences of that last paragraph of the Opinion were *not* deleted on rehearing, see Appendix C.

III. The "End Result"[9] Of The Commission's Position Here, Together With Its Other Decisions, Is To Confiscate Shell's Property Without Due Process Of Law.

As previously discussed, having denied any consideration of the market value royalty problem in the area and national rate cases determining producer ceiling rates, the Commission now seeks to deny relief in an individual proceeding for special relief. The result is confiscation of the producers' leases, as the margin between the static ceiling price and the increasing royalty cost becomes narrower and finally disappears. Yet, the Commission's position is that it cannot even *consider* this question, in a specific proceeding and record on which the issues are presented. In other words, there is no proceeding before

9. Under *Permian, supra,* and *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), it is the "end result" of the Commission's decision which is the subject of Court review.

the Commission where the producer can obtain relief from this confiscation of his property, even though one side of the pincers, the ceiling rate, is clearly under the Commission's control.[10]

The Commission suggests in its Petition (p. 17) that this Court could resolve the question by reconsidering its denial of certiorari from the 1972 decision of the Court of Appeals for the District of Columbia Circuit in *Mobil Oil Corporation v. F.P.C.*, 463 F.2d 256 (1971), and find that "the producer/lessees need not pay royalties which exceed the amounts permitted by the Commission to be passed on to jurisdictional pipelines". Shell would certainly support such a finding. In fact, this is basically the same result urged on this Court in Shell's Petition for Certiorari from the same *Mobil* decision, Case No. 71-1191, October Term, 1971. That Petition was denied by this Court on June 7, 1972, 406 U.S. 976.[11]

Another alternative offered by the Commission (p. 18) is the reconsideration by this Court of its denial of certiorari from the decision of the Kansas Supreme Court in *Mobil Oil Corp. v. Lightcap,* Case No. 76-1694, certiorari denied October 3, 1977. Shell would also support that result.

Unless and until the Court reverses those two cases, together with *J. M. Huber Corporation v. Denman, supra* and *Texas Oil and Gas Corp. v. Vela, supra,* the

10. Shell could not have anticipated this problem and contracted against it, as one lease was executed before the passage of the Natural Gas Act, and the other before this Court's decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

11. This Court denied a similar Petition for Writ of Certiorari by the Solicitor General (Case No. 71-1326, October Term, 1971) by the same Order.

Commission cannot escape the responsibility to at least allow Shell the opportunity to recover its increased royalty costs a hearing on the merits in its individual proceeding for special relief, the procedure indicated by this Court in *Mobil Oil Corp. v. F.P.C.*, 417 U.S. 238 (1974) to be the appropriate one. Due process requires that such a hearing be permitted. The decision of the Court of Appeals directing the Commission to hear the case on the merits should be affirmed, and the Petition for Writ of Certiorari denied.

Respectfully submitted.

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